

**The Internal Revenue Service Should Expand
the Successful Automation of Payment
Processing to Include Additional Documents**

August 2003

Reference Number: 2003-40-159

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

August 1, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Assistant Inspector General for Audit (Small Business and
Corporate Programs)

SUBJECT: Final Audit Report - The Internal Revenue Service Should
Expand the Successful Automation of Payment Processing
to Include Additional Documents (Audit # 200240051)

This report presents the results of our review of the Internal Revenue Service's (IRS) payment processing operation. The overall objective of this review was to determine if the IRS is efficiently and effectively processing payments on balance due accounts received from taxpayers at its Submission Processing Sites.

In summary, we identified two types of cases that could benefit from the IRS providing the taxpayer with an improved posting document that could be submitted with a remittance: balance due notices¹ sent directly to the taxpayer, and levies¹ soliciting payments from third parties on behalf of the taxpayer.

During the course of our review, we learned that the IRS had initiated actions to improve the processing of payments by standardizing "scan lines" on the tear off vouchers on balance due notices. We commend the IRS for these efforts. The standard scan lines allow the IRS to automate the processing and posting of taxpayer payments and significantly improve the efficiency of processing payments from balance due notices.

Although the IRS has plans to expand this concept, we identified an additional area for consideration to increase automated payment processing. Specifically, we recommended that the Commissioner, Wage and Investment Division, consider developing payment vouchers with a standardized scan line that could be included with levies issued to third party payers to help facilitate the processing of subsequent remittances.

¹ See Glossary of Terms, Appendix V.

Management's Response: The IRS was pleased that our report recognized the improvements it has made in its payment processing. These improvements increased efficiency and reduced taxpayer burden. IRS management plans to continue to expand the use of technologies to improve payment processing.

IRS management agreed with the concept of implementing a voucher system for third party payments received as a result of a levy. While they maintained that numerous road blocks prevent the IRS from implementing such a system in the near future, IRS management agreed to review the feasibility of using standardized scan lines when processing payments received as a result of levy action. This review will be part of a broader multi-functional initiative of the entire levy process that will begin in the first quarter of Fiscal Year 2004.

IRS management also pointed out that any benefits derived from a voucher system for levies would only apply to the payments received as a result of the levies issued and should not be based on the number of levies issued, since many levies do not result in a payment or do not result in recurring payments. These situations are frequent and substantially reduce the value of a voucher system for levies. As a result, management disagreed with our Outcome Measure as reported.

Management's complete response to the draft report is included as Appendix VI.

Office of Audit Comment: We agree that the variables of some levies may preclude the use of a scanable payment voucher. However, we believe the majority of levies issued could be effectively processed through the IRS' automated systems if scanable vouchers were provided with levies issued to third party recipients. Results from our judgmental sample of 201 payments requiring manual research to ensure proper posting to taxpayer accounts showed that 54 percent were from third parties for levies issued against delinquent taxpayers.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

**The Internal Revenue Service Should Expand the Successful Automation
of Payment Processing to Include Additional Documents**

Table of Contents

Background	Page 1
The Internal Revenue Service Has Significantly Improved the Efficiency of Processing Payments.....	Page 2
Opportunities Exist to Increase Automated Payment Processing.....	Page 3
<u>Recommendation 1:</u>	Page 5
Appendix I – Detailed Objective, Scope, and Methodology	Page 6
Appendix II – Major Contributors to This Report.....	Page 8
Appendix III – Report Distribution List	Page 9
Appendix IV – Outcome Measure.....	Page 10
Appendix V – Glossary of Terms	Page 11
Appendix VI – Management’s Response to the Draft Report	Page 13

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

Background

The Internal Revenue Service (IRS) collected over \$2 trillion in Fiscal Year (FY) 2002.¹ This included more than 33 million payments totaling over \$99 billion² that were received and processed through the 10 IRS Submission Processing Sites.

When payments arrive at the Submission Processing Sites, they are reviewed and sorted into two categories – “perfect” and “imperfect.” Perfect payments contain sufficient information to be sent directly to the Residual Remittance Processing System (RRPS)³ and posted to the taxpayer’s account. Specifically, the documentation must include the taxpayer’s name, the Taxpayer Identification Number (TIN), and the tax period, all in the proper format.

Imperfect payments lack one or more pieces of information that are necessary to process the payment. These imperfect payments are sent to the Payment Perfection Unit (PPU)³ for additional research. Once the research has been completed and the payment is perfected, it is sent to the RRPS for processing.

In addition to imperfect payments, other types of documents must be routed through the PPU for additional research.

- Payments for more than one tax period, or more than one check or money order as one payment.
- Payments larger than \$5,000.
- Payments received in IRS field offices but forwarded to a Submission Processing Site for processing.
- Payments initially received by one of the IRS’ lockbox operations that could not be processed by the lockbox.
- Payments with correspondence from taxpayers attached.

Information developed during a recent review of payment processing operations indicated that additional research had

¹ Source: IRS Data Book, FY 2002, Publication 55b.

² Source: Deposit Daily Report Summary, 2001, 2002.

³ See Glossary of Terms, Appendix V.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

to be done on a high percentage of remittances before they could be processed. This concern was reinforced by a comment from an operations manager who speculated that as many as 50 percent of the remittances received were imperfect. As a result, we initiated this review to determine whether the IRS could take steps to improve the efficiency of the payment processing operation by reducing the number of imperfect payments.

We performed our field tests at the Austin, Texas, and Ogden, Utah, Submission Processing Sites, the Ogden National Print Site (NPS),⁴ and at the IRS National Headquarters in New Carrollton, Maryland. We also analyzed payment processing data from all 10 Submission Processing Sites. Field work was performed between May 2002 and February 2003. The audit was conducted in accordance with *Government Auditing Standards*.

Detailed information on our audit objective, scope and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II. A glossary of terms used is included in Appendix V.

The Internal Revenue Service Has Significantly Improved the Efficiency of Processing Payments

At the beginning of this audit, we reviewed 201 payments being processed through the Austin Submission Processing Site's PPU to identify the types of cases that required additional research. Our results identified two types of cases that could benefit from the IRS providing the taxpayer with a posting document that could be submitted with the remittance: balance due notices⁴ sent directly to the taxpayer, and levies⁴ soliciting payments from third parties on behalf of the taxpayer.

During the course of our review, we learned that the IRS had also recognized the problem of too many imperfect payments and had initiated actions to reduce the number of payments that required additional research before they could be posted to the correct account. The IRS has recently improved the processing of payments by standardizing "scan lines" on the tear off vouchers at the end of balance due notices. These vouchers are returned to the IRS by

⁴ See Glossary of Terms, Appendix V.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

taxpayers with their payments and used as posting documents. The standardized scan lines allow the IRS to automate the processing and posting of taxpayer payments.

After we learned of the IRS' efforts to add standardized scan lines to notices of tax deficiencies that were mailed to taxpayers, we added tests to our review that evaluated the effectiveness of the new scan lines. We wanted to ensure that the new scan lines contained complete and consistent information and that RRPS equipment could process the documents.

The IRS is adding the scan lines in conjunction with another project to consolidate the printing and mailing of all notices. Two NPSs have been established, and systems have been designed to print and mail notices from these two sites. We visited the NPS at the Ogden Campus⁵ and reviewed 295 balance due notices. We found that the scan lines on all of the notices we reviewed contained complete information that could be processed through the RRPS.

We then selected two batches of payments (approximately 200 payments) and monitored the process as the payments were sent through the Ogden Submission Processing Site's RRPS system. In 1 batch, 2 of the 100 payments appeared on an error report. Both errors were scanning (machine) errors, rather than problems with the payment documents. The section chief said that this was routine and demonstrated the correction process. She was able to bring up both payments on a computer monitor and quickly correct the errors, without sending the payments to the PPU. Processing on the two payments was then completed on the RRPS.

Opportunities Exist to Increase Automated Payment Processing

We commend the IRS for the efforts to automate payment processing. We consider the steps taken to use posting vouchers with machine-readable scan lines to be a significant improvement in the efficiency of processing payments. Although the IRS has plans to expand this concept, we have identified another area for consideration involving levies issued to third parties.

⁵ See Glossary of Terms, Appendix V.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

When taxpayers refuse to pay delinquent taxes, the IRS has the authority to work directly with financial institutions and other third parties to confiscate taxpayers' assets, such as bank accounts and wages. This action is commonly referred to as a levy.

Levies are issued from both the Automated Collection System (ACS) and the Collection Field function (CFf). In FY 2002, the IRS issued 1,140,628⁶ levies through the ACS and another 143,255⁷ levies through the CFf.

Not all levies issued result in payments to the IRS. For instance, there may be no assets to confiscate, or, as a result of the levy, the taxpayer may contact the IRS to make other payment arrangements, so the levy is released. Of the levies that do generate proceeds, some involve a single payment, while others involve multiple payments.

Initial proceeds from a levy are returned with a posting document that is part of the levy form, called Notice of Levy on Wages, Salary, and Other Income⁸ (Form 668-W(c)(DO)) and are processed with that document. However, if a levy results in continuing payments from a taxpayer's wages, those payments after the first one have no accompanying payment document.

In our review of 201 imperfect payments requiring manual research in Austin, 108 (54 percent) were levy payments to an individual taxpayer account with the check drawn on a business entity such as the taxpayer's employer. There was no voucher or other posting document included with these payments.

Providing machine scanable posting vouchers when levies are issued would help reduce the number of payments requiring manual research. This could also allow many levy payments to be processed through the automated systems of

⁶ Source: ACS' Customer Service Activity Reports, FY 2002.

⁷ Source: Collection Report 5000-23, FY 2002.

⁸ Form 668-W(c)(DO) is used by Compliance function employees (primarily revenue officers in area offices and posts of duty) responsible for the collection of delinquent taxes. The form is sent to employers and other third parties to attach a taxpayer's wages, salary, and any other income so it can be applied to delinquent taxes.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

the RRPS rather than through manual processes, resulting in more accurate, timely, and efficient processing.

Recommendation

1. The Commissioner, Wage and Investment Division, should consider the feasibility of developing payment vouchers having a standardized scan line that could be included with levies issued to third party payers to help facilitate the processing of subsequent remittances.

Management's Response: IRS management agreed to review the feasibility of using standardized scan lines when processing payments received as a result of levy action. This review will be part of a broader multi-functional initiative of the entire levy process that will begin in the first quarter of FY 2004.

IRS management also pointed out that any benefits derived from a voucher system for levies would only apply to the payments received as a result of the levies issued and should not be based on the number of levies issued, since many levies do not result in a payment or do not result in recurring payments. These situations are frequent and substantially reduce the value of a voucher system for levies. As a result, management disagreed with our Outcome Measure as reported.

Office of Audit Comment: We agree that the variables of some levies may preclude the use of a scanable payment voucher. However, we believe the majority of levies issued could be effectively processed through the IRS' automated systems if scanable vouchers were provided with levies issued to third party recipients. Results from our judgmental sample of 201 payments requiring manual research to ensure proper posting to taxpayer accounts showed that 54 percent were from third parties for levies issued against delinquent taxpayers.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine if the Internal Revenue Service (IRS) is efficiently and effectively processing payments on balance due accounts received from taxpayers at its Submission Processing Sites. To accomplish this, we:

- I. Determined if the IRS is working to improve balance due notices¹ sent to taxpayers to include sufficient and accurate information to process payments without additional research.
 - A. Identified which notices are sent to taxpayers with balance due accounts.
 - B. Determined how many notices are sent to taxpayers.
 - C. Researched IRS documents and websites regarding notice improvement projects and interviewed analysts and managers involved in notice improvement to determine if the IRS is considering sending notices to entities that send checks on behalf of other taxpayers.
 - D. Researched Requests for Information Services (RIS)² to determine if the standards for the “scan lines” on notices were sufficient and being applied to all notices.
- II. Determined if the IRS had established standards/criteria for processing payments as “perfect” and “imperfect” and if the standards were properly and consistently applied at the various Submission Processing Sites by sending a questionnaire to all Submission Processing Sites.
 - A. Determined the definition of a perfect payment (all information necessary to post payment without additional research).
 - B. Determined if the Submission Processing Sites had any local procedures.
 - C. Gathered data for analysis and comparison of determinations of imperfect payments between multiple Submission Processing Sites.
- III. Determined if the IRS had applied the standard set out in RIS # TSF-0-0109³ to all applicable balance due notices.

¹ See Glossary of Terms, Appendix V.

² A RIS is a formal request for automated computer support to Information Systems, initiated by a customer area.

³ RIS # TSF-0-0109 (dated March 2, 2000) stated that payment coupons on “... all scannable vouchers and notices will be designed to a standard format.” It also contained the specifications of the standard format.

**The Internal Revenue Service Should Expand the Successful Automation
of Payment Processing to Include Additional Documents**

- A. Interviewed Headquarters managers and analysts to determine the status of applying the standard scan line to all notices.
- B. Made a site visit to the Ogden Campus⁴ to confirm that the scan line conforms to RIS # TSF-0-0109. To accomplish this, we:
 - 1. Reviewed 295 notices at the National Print Site (NPS).⁴
 - 2. Interviewed NPS quality reviewers and the NPS analyst.
 - 3. Inspected 35 remittances in the Ogden Submission Processing Site's Payment Perfection Unit.
 - 4. Interviewed submission processing personnel and observed processing of 200 scanable notice stubs through the Residual Remittance Processing System.⁴

⁴ See Glossary of Terms, Appendix V.

**The Internal Revenue Service Should Expand the Successful Automation
of Payment Processing to Include Additional Documents**

Appendix II

Major Contributors to This Report

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Gary L. Young, Acting Director

Stephen S. Root, Audit Manager

David Brown, Senior Auditor

Jacqueline Nguyen, Senior Auditor

Susan A. Price, Senior Auditor

Stephen Holmes, Auditor

**The Internal Revenue Service Should Expand the Successful Automation
of Payment Processing to Include Additional Documents**

Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner for Services and Enforcement N:SE
Deputy Commissioner, Wage and Investment Division W
Director, Customer Account Services W:CAS
Director, Strategy and Finance W:S
Director, Submission Processing W:CAS:SP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M
Audit Liaison: GAO/TIGTA Liaison, Wage and Investment Division W:S:PA

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

Appendix IV

Outcome Measure

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; 1,283,883 levies¹ issued in Fiscal Year (FY) 2002 (see page 3).

Methodology Used to Measure the Reported Benefit:

In FY 2002, there were 1,140,628² levies issued through the Automated Collection System and another 143,255³ levies issued by the Collection Field function. Initial proceeds from a levy are returned with a document that is part of the Internal Revenue Service's (IRS) levy form (Form 668) and are manually processed with that document. However, if a levy results in continuing payments from a taxpayer's wages, subsequent payments after the first payment have no accompanying payment document. Machine scanable posting vouchers supplied with levies would allow all such payments to be processed through the automated systems of the IRS.

As mentioned earlier in this report, the variables of some levies may preclude the use of a scanable payment voucher. However, we believe the majority of levies issued could be effectively processed through the IRS' automated systems if scanable vouchers were provided with levies issued to third party recipients. We recognize that some issued levies may not be returned with payments. Results from our judgmental sample of 201 payments requiring manual research to ensure proper posting to taxpayer accounts showed that 54 percent were from third parties for levies issued against delinquent taxpayers.

Inefficient Use of Resources is used here to demonstrate the value of our audit recommendation on tax administration and business operations. This issue is of interest to the IRS and Treasury executives, the Congress, and the taxpaying public, and is expressed in quantifiable terms to provide further insights to the value of the entity affected and potential impact of the issue.

¹ See Glossary of Terms, Appendix V.

² Source: ACS' Customer Service Activity Reports, FY 2002.

³ Source: Collection Report 5000-23, FY 2002.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

Appendix V

Glossary of Terms

Campus: The campuses are the data processing arm of the Internal Revenue Service (IRS). The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

Levy: When taxpayers refuse to pay delinquent taxes, the IRS has authority to work directly with financial institutions and other third parties to seize taxpayers' assets. This action is commonly referred to as a levy.

Two operations within the IRS issue levies to collect delinquent taxes: the Automated Collection System (ACS), where customer service representatives contact delinquent taxpayers by telephone to collect unpaid taxes and secure tax returns; and the Collection Field function, where revenue officers contact delinquent taxpayers in person as the final step in the collection process. Field contact becomes necessary when the tax matter is not resolved by the ACS.

National Print Site (NPS): The NPS initiative is transitioning the vast majority of taxpayer notice printing and mailing activities from 10 Submission Processing Sites to 2 new sites in Detroit, Michigan, and Ogden, Utah. The business process improvements associated with the NPS, based on state-of-the-art technologies, will enhance online access to notice information by IRS customer service representatives. The business process improvements will also permit economies of scale in generating and sending correspondence, allow the IRS to maximize postal discounts, and substantially improve management information available on the Taxpayer Notice Program.

Notice: Computer-generated messages resulting from an analysis of a taxpayer's account. The types of notices and their purposes are:

- Settlement Notices – notices of assessments of tax due, payments, adjustments, balance due, or overpayment that are sent to the taxpayer.
- Taxpayer Inquiry Letters – requests to the taxpayer for additional information or documents needed to process the taxpayer's return correctly.
- Submission Processing Site Notices – issued to request information and alert submission processing/customer service sites of certain conditions necessary to correct or update taxpayers' accounts. These are researched in the submission processing/customer service sites or area offices and used internally only.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

Payment Perfection Unit (PPU): The PPU, within the Deposit Activity, performs analysis and research on remittances and returns/documents that require additional preparation prior to depositing money. It also codes or edits for other functional areas to ensure all taxpayer information is available to credit a taxpayer's accounts.

Residual Remittance Processing System (RRPS): The RRPS is a multi-functional remittance processing system for processing payments and controlling related source documents. It computerizes the recap of each day's deposit information, simultaneously preparing tapes to post credits to taxpayers' accounts.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

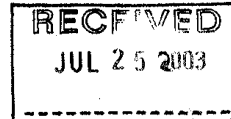
Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

July 25, 2003



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

FROM: Henry O. Lamar, Jr. *[Signature]*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents (Audit No. 200240051)

I am pleased that your report recognizes the improvements we made in our payment processing. Using standardized scan lines on our notices allows us to automate processing and posting payments. We increased efficiency and reduced taxpayer burden by improving the accuracy of matching tax payments to their proper accounts. We will continue to expand our use of technologies like this to improve our payment processing.

We agree that as we increase the accuracy and efficiency of payment processing, we will save some staff resources and reduce taxpayer burden. We also agree with the concept of implementing a voucher system for third party payments received as a result of a levy. However, numerous roadblocks prevent us from implementing such a system in the near future. We identified the following obstacles in our preliminary consideration of a voucher system:

- Large employers often make one payment for multiple taxpayers.
- We often issue levies for multiple periods or types of tax, and we must designate levy payments we receive for the appropriate period and type of tax.
- When levy action is initiated, we cannot determine the number of vouchers that would be required to satisfy the tax debt.
- Due to equipment limitations, we cannot produce perforations on forms. Perforations permit the use of uniformly sized vouchers that can be processed by the Residual Remittance Processing System (RRPS) machines.

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

2

- Representatives of Small Business and Self-Employed Collection Field function (CFF) do not believe that a voucher system is practical. Third party payments resulting from CFF levy action must be received and allocated by the CFF levy initiator to the taxpayers' debt.

I recognize that the Outcome Measure is stated as a potential savings based on your assumption that a voucher system would save an undetermined amount of staff resources. Your report states we issued 1,283,883 levies in Fiscal Year 2002 and uses the number of levy actions as a basis for the reported benefit. Any benefit derived from a voucher system would only apply to the payments received as a result of the levies issued and should not be based on the number of levies issued. There is not a one to one correlation of levies to payments. Many levies do not result in a payment because the levy does not attach to any taxpayer funds. A large number of our levies are directed to financial institutions and do not result in recurring payments. In other instances we release the levy without a payment from a third party when taxpayers contact us and make arrangements to resolve their delinquent tax situation. Because these situations are so frequent, they substantially reduce the value of a voucher system as the expense of printing and administering vouchers would not be offset by any benefit. Because of these reasons and the other barriers that we identified, I disagree with Outcome Measures shown in the report.

Your recommendation that we consider the feasibility of developing a voucher system provides us with appropriate latitude for future consideration. Despite the results of our preliminary review, we have not dismissed the value of the concept. The Director of Wage and Investment, Filing and Payment Compliance will soon undertake a comprehensive study of the entire levy process. This multi-year effort will involve all operating divisions affected by the levy processes. All phases of the levy process will be reviewed to identify improvement opportunities. We will consider the feasibility of this recommendation as part of that process. We believe that improvements in other areas may reduce or eliminate some of the impediments that exist in our current operating environment.

I appreciate your in-depth review and positive recognition of the progress we have made to improve payment processing.

If you have any questions, please call me or Ronald S. Rhodes, Director, Customer Account Services, at (404) 338-8910.

Attachment

The Internal Revenue Service Should Expand the Successful Automation of Payment Processing to Include Additional Documents

Attachment

RECOMMENDATION

The Commissioner, Wage and Investment Division, should consider the feasibility of developing payment vouchers having a standardized scan line that could be included with the levies issued to third party payers to help facilitate the processing of subsequent remittances.

CORRECTIVE ACTION

We agree to review the feasibility of using standardized scan lines when processing payments received as a result of levy action. We will complete a feasibility review as part a broader initiative focused on the entire levy process. This multi-functional initiative will begin in the first quarter of Fiscal Year 2004, and we will consider the feasibility of the recommendation no later than September 30, 2004.

IMPLEMENTATION DATE

September 30, 2004

RESPONSIBLE OFFICIALS

Director, Wage and Investment, Filing and Payment Compliance

CORRECTIVE ACTION MONITORING PLAN

Implementation of this corrective action will be monitored through our internal control system and managerial oversight.